IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

Nos. 278, 279, 280, 281,
282, 286 and 291

IN THE MATTER

of

THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY,

Debtor.

RECONSTRUCTION FINANCE CORPORATION, INSURANCE GROUP COMMITTEE, et al.,

Petitioners,

against

THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, et al.,

Respondents.

(and the other six cases numbered above)

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF IN OPPOSITION

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August 31, 1945.

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BRIEF IN OPPOSITION

Introductory

Three petitions for writs of certiorari have been filed, each asking this Court to review some part of a decision by the United States Circuit Court of Appeals for the Tenth Circuit entered on May 10, 1945. The decision involves a

proposed plan of reorganization (herein called the "Plan") of The Denver and Rio Grande Western Railroad Company (herein called "Debtor") under Section 77 of the Bankruptcy Act.

The petitions filed by the Debtor and by Guy A. Thompson, Trustee of Missouri Pacific Railroad Company (holder of half of Debtor's common stock) seek to have reviewed the part of the decision below which upheld the valuation of Debtor's property fixed by the Interstate Commerce Commission (herein called the "Commission"), and which held that the preferred and common stock of the Debtor are without value. The Court below affirmed the District Court on these matters.

The other certiorari petition was filed by Reconstruction Finance Corporation, Insurance Group Committee, and others. It seeks a review by this Court of that part of the decision below which, while accepting the valuation and framework of the Commission's Plan, held that the proposed treatment of the General Mortgage Bondholders was inequitable and unfair and that the rejection of the Plan by the General Mortgage Bondholders was reasonably justified within the meaning of the statute. On these questions the Circuit Court of Appeals reversed the District Court.

The Debtor's certiorari petition correctly urges that the Insurance Group petition is without merit and should be denied. The Debtor asks for a review of the matters covered by Debtor's petition only in the event this Court should grant the Insurance Group petition.

This brief will be limited to showing that the Insurance Group petition is without merit and should be denied. Unless otherwise indicated, all references herein (a) to the "petitioners" refer to the group consisting of the Reconstruction Finance Corporation, Insurance Group Committee, and others, and (b) to the "petition" refer to the petition dated July 31, 1945 filed by that group.

Opinions Below

The opinions of the Circuit Court of Appeals for the Tenth Circuit (R. 233-262)* and of the District Court (R. 187-206, 213-224) are not yet officially reported.

Questions Presented

1. Is a plan of reorganization which fails to provide for the distribution to creditors of the full amount of capitalization which the Commission found proper for the reorganized Debtor inequitable and unfair to junior creditors, who under the plan are receiving only 10% of their claim in new common stock, the remaining 90% of their claim being forever destroyed?

2. Is a plan of reorganization which awards to one class of senior creditors 100% of its claim in securities of the reorganized Debtor and also awards to that class of creditors all of the outstanding shares of the capital stock of another corporation, without determining the value of such capital stock, inequitable and unfair to junior creditors who have a junior lien upon such capital stock and who under the plan are receiving only 10% of their claim in securities of the reorganized Debtor and are having 90% of their claim wiped out?

3. Is a plan of reorganization which gives senior creditors their claims in full by awarding them 100% of their claim in securities of the reorganized Debtor and which, in addition, gives the senior creditors surplus cash on hand, earnings already accumulated and excess war profits inequitable and unfair to junior creditors, 90% of whose claim is to remain unsatisfied?

The Circuit Court of Appeals, in holding the Plan inequitable and unfair, determined the foregoing questions in favor of this respondent (R. 247-8, 250-1, 251-3). The decision of the Circuit Court of Appeals on these questions

* "R." refers to pages in abbreviated record printed pursuant to July 16, 1945 stipulation herein.

does not come within any of the classifications listed in paragraph 5 (b) of this Court's Rule 38. It is respectfully submitted that, if this Court were to review the decision below on the foregoing questions, it would reach the same result. Whether or not that is so, unless this case comes within one of the categories of Rule 38 (and it is respectfully submitted that it does not), the petitioners are not entitled to another appeal merely because this Court might not fully agree with the Court below or might have used different language in deciding certain of the questions.

Were the Court below to be reversed with respect to each aspect of the Plan which it considered and found inequitable and unfair, an additional question would be presented:

4. In the light of all the relevant facts contained in the voluminous record before the Circuit Court of Appeals, were the General Mortgage Bondholders reasonably justified in voting in May, 1944, by a four-to-one vote to reject the Plan?

The Circuit Court of Appeals ruled on this question 4, holding that the General Mortgage Bondholders "were reasonably justified, within the meaning of the statute, in rejecting the plan" (R. 253) and that, accordingly, the District Court erred in confirming the Plan in the face of their adverse vote (R. 253). This respondent submits that the Circuit Court of Appeals held correctly, but that the ruling was not necessary to the decision of the case because the Circuit Court of Appeals had already properly held the Plan inequitable and unfair. It seems too clear for argument that this is not the type of question that this Court should review, requiring as it does the consideration and weighing of *all* the evidence.

Were this Court to reverse the Court below on all of the questions already mentioned, even another question would be presented:

5. May Section 77 of the Bankruptcy Act properly be construed as giving the District Court power to confirm the Plan after 79.33% of the General Mortgage Bondholders

voting had rejected it; or is such construction an unwarranted and unconstitutional extension of the bankruptcy power?

This question 5 was raised below, but the Circuit Court of Appeals did not undertake to decide it. It clearly is not necessary for this Court to consider this last question unless this Court were to review, and to reverse, the Circuit Court of Appeals on all of the earlier questions.

The questions propounded by the petitioners

The petitioners, in stating what they conceive to be five questions which they believe this Court, under its Rule 38, should review on writ of certiorari, have misconstrued the opinion below in framing each of these questions and have made several errors. The questions which they assert should be here reviewed are not presented by the Circuit Court of Appeals decision.

The general question as stated by the Circuit Court of Appeals

After upholding the Commission's valuation of the Debtor's property for reorganization purposes, and affirming the District Court on this point, the Circuit Court of Appeals summed up the remaining problem as follows:

> "In considering whether the plan is fair and equitable, affords due consideration to the rights of each class of creditors, and whether it does not discriminate unfairly in favor of one class at the expense of another, *our problem is to determine whether within the framework of the capital structure set up by the Commission the assets have been distributed to the various classes of claimants within the rule of Northern Pac. Ry.* v. *Boyd*, 228 U. S. 482, and *Consolidated Products Co.* v. *DuBois*, 312 U. S. 510. These cases merely reiterate the well established equitable rule *that property of an insolvent corporation must be used to satisfy in full the claims of various classes of creditors according to their priority in rank*" (R. 246).*

* Unless otherwise indicated, all emphasis—by way of italicization or otherwise—is supplied.

The Circuit Court of Appeals held unanimously that, within the capitalization fixed by the Commission, that part of the Plan which proposed forever to wipe out 90% of the claim of the Debtor's General Mortgage Bondholders, is unfair and inequitable, and that the General Mortgage Bondholders were reasonably justified in rejecting the Plan by a vote of 4 to 1. This finding was based upon uncontroverted evidence showing that after all claims senior to the General Mortgage Bondholders were taken care of in full, there would remain within the valuation and capitalization fixed by the Commission securities available for distribution to the General Mortgage Bondholders of a par value substantially in excess of the $4,354,816, of stock allotted to them in the Plan. The Court left all adjustments for the Commission to make, expressly recognizing that claims of various classes of creditors must be taken care of "according to their priority in rank" (R. 246). The Court did not make, or suggest, any award of cash or new senior securities to the General Mortgage Bondholders, and petitioners' assertions to the contrary (petition 2, 3, 10, 12, 13, 15, 16) are erroneous.

The Statute Involved

The statute involved is Section 77 of the Bankruptcy Act (11 U. S. C. 205), particularly subsection (e).

STATEMENT

The Debtor's General Mortgage

This respondent, City Bank Farmers Trust Company, is the trustee of the Debtor's General Mortgage, under which $29,808,000, principal amount, of General Mortgage Bonds are outstanding (R. 37). The total General Mortgage claim as of the proposed effective date of the Plan, January 1, 1943, aggregated over 43½ million dollars (R. 183) and today amounts to almost 48 million dollars. The General Mortgage Bonds constitute almost one-fourth of

the Debtor's entire indebtedness and are the Debtor's junior bonds. The holders of the General Mortgage Bonds voted 79.33% to 20.67% (or about 4 to 1 of those voting) to reject the Plan (R. 266).

The Plan

The Plan under consideration is that embodied in the Interstate Commerce Commission's Third Supplemental Report and Order dated June 14, 1943, 254 ICC 349 (R. 151-186). The Plan is in the alternative, with or without consolidation with the Denver & Salt Lake. A summary of the Plan, without such consolidation, is given in Appendix B to the report (R. 183), a total capitalization of $143,528,027 being authorized (R. 159, 184). Throughout this brief, figures applicable to reorganization without such consolidation will be used consistently to avoid confusion.

The Plan is a drastic reorganization plan. Under it the General Mortgage Bondholders receive 10% of their claim in new common stock (being about 12% of the total new common stock). The remaining 90% of their claim is wiped out—that is, approximately 39 million dollars of their claim is forever cancelled. The Plan also wipes out (a) the Debtor's unsecured indebtedness aggregating about 440 thousand dollars, (b) the Debtor's preferred stock outstanding in the amount of 16½ million dollars, and (c) the Debtor's 300,000 shares of common stock, carried on the balance sheet at about 62½ million dollars. All in all, the Plan eliminates claims aggregating, as of the proposed effective date, over $118,300,000 (R. 36-7, 183).

Because of developments since the Plan was proposed by the Commission, were the Plan now to be put into operation, the capitalization of the reorganized Debtor would *not* be 143½ million dollars, the amount authorized by the Commission, but something less than 140 million dollars—notwithstanding the fact that in the meantime the value and earning capacity of the property have been substantially increased and the net working capital position has been greatly improved. The elimination of 3½ million dollars, or more, from the already drastically reduced capitalization

authorized by the Plan would be a serious injustice to the General Mortgage Bondholders.

The senior creditors

The Commission and the District Court have found in effect, and the Circuit Court of Appeals has agreed (R. 247, 251), that the claims of all creditors senior to the General Mortgage Bondholders were satisfied in full by the treatment proposed for such creditors in the Plan. Obviously that must be so if there was anything at all left over for distribution to the General Mortgage Bondholders. All of the plans at any time proposed for the Debtor have provided new securities for the General Mortgage Bondholders—100% of their claim in new preferred or common stock in the first plans, 10% in the present Plan (R. 350). The three plans proposed by the senior security holders during the course of the reorganization proceedings gave the General Mortgage Bondholders a maximum of 100% and a minimum of 47.42% of their claim in new stock (R. 350).

By their conduct throughout, the senior creditors have acquiesced in the proposition that some "value" for reorganization purposes is available for distribution to the General Mortgage issue. They support this present Plan. They supported it when it came before the District Court for approval in September, 1943. Moreover, when the earlier plans were proposed, they never urged that any of them treated the General Mortgage Bondholders too favorably. As a matter of fact, an examination of the record discloses that whenever the Commission or its examiner proposed a plan, the senior security holders, in their *very next* plan, proposed that *better* treatment be accorded the General Mortgage issue (R. 350).

History

Circuit Judge Phillips in his concurring opinion summarized pertinent features of the Plan and its history as follows:

> "On November 1, 1935, during the depths of the national depression, the debtor came into court for

reorganization. At that time the debtor's senior debts ahead of the general mortgage bonds aggregated slightly over $101,000,000 and the claim of the general mortgage bondholders aggregated about $30,000,000. With an immediate reorganization, a capitalization of $132,000,000 would have been adequate to give the general mortgage bondholders new stock equal to 100 per cent of their claim. *No capitalization or valuation ever proposed for the debtor, in any plan presented, has been that low.* During the eight years' delay in reorganization (in nowise due to the general mortgage bondholders, but, at least in part, to controversies among the senior security holders) and up to January 1, 1943, the effective date of the plan, the claims of the senior security holders, due to the accrual and nonpayment of interest, increased about $38,000,000. The debtor's net income available for interest during the trusteeship to the end of 1944 amounted to $49,420,972. *It exceeded by approximately $9,500,000 the interest charges which accrued on the claims of senior security holders to the end of that year.* As of December 31, 1935, the debtor's current assets were $9,727,230 less than its current liabilities. As of December 31, 1944, the debtor's current assets exceeded its current liabilities by $12,125,863.50. *Thus, it will be seen there has been a favorable change in the current situation of $21,853,093,* and, moreover, since the plan was formulated, the Junction Bonds have been paid and equipment obligations have been reduced from $5,758,000, the amount provided for in the plan, to $4,540,000, a reduction in that requirement of $1,218,000.

"Approximately $43,000,000 of the income available, but not used, for the payment of interest has been expended in permanent improvements and betterments. While the investment value of the debtor's property thus was substantially increased, the Commission's valuation, based on estimated future earnings, was not increased proportionately. As a result, the claim of the senior security holders has increased and the participation of the general mortgage bondholders has been pressed downward until it is now fixed at 10 per cent of the new common stock. Many of the improvements and betterments referred to

above, have substantially increased the capacity of the railroad to handle increased traffic as it arises * * *" (R. 256-8).

The situation is similarly summed up by Circuit Judge Huxman, in the Court's opinion, in which Circuit Judges Phillips and Murrah both concurred (R. 248-9).

Notwithstanding these facts, Judge Phillips felt constrained to hold:

> "The broad language of the Supreme Court in the Western Pacific case and the Milwaukee case compels me to conclude that we cannot disturb the Commission's finding of valuation * * *." (R. 254)

The Court's opinion by Judge Huxman, in which all concurred, held similarly:

> "It is settled beyond the question of a doubt by the decisions of the Supreme Court in Ecker *v.* Western Pac. R. Co., and Group of Investors *v.* Milwaukee R. Co., supra, and in the special concurring opinions of Justice Roberts in those cases, that the duty of formulating a plan of reorganization under Section 77, including the adoption of a new valuation of the property, is a function confided to the Interstate Commerce Commission, and that no court of law may interfere with such plan or valuation because it does not agree with it. * * * Courts may interfere with the capital structure or valuation made by the Commission in a proceeding under this Act only when it can be said as a matter of law that the Commission used fundamentally erroneous methods of valuation or acted arbitrarily or capriciously. An examination of the entire record leads to the conclusion that the action and the conduct of the Commission in fixing the valuation and setting up the capital structure is free from these infirmities, and that its action in relation thereto must be upheld." (R. 244-5)

There is no basis for the assertions in the petition that the Court below failed to follow the decisions of this Court.

Earnings

The statements in the petition relative to the Debtor's earnings are incomplete and misleading. The Debtor's earnings record has been good except for the depression years. In the six years preceding the depression, 1925 to 1930, inclusive, the Debtor's net income available for interest ranged between 6½ and 8¾ million dollars annually (R. 348). Since the end of 1941 (and the making of a substantial part of the investment of 43 million dollars in permanent improvements, mentioned in Judge Phillips' opinion), the Debtor's net available for interest has been running between 10 and 17 million dollars annually (R. 280-1; 348, 349). There is undisputed testimony in the record that the improvements can be expected to yield a return of 10 to 15 per cent or even more (R. 316-7). That would indicate an increase in earnings, resulting from the improvements, of between 4 and 6½ million dollars a year. There have been some property retirements, but unchallenged testimony is in the record that these abandonments and retirements have *improved* the earning capacity of the road (R. 332) and hence *increased* its value for reorganization purposes.

The Debtor's annual interest requirements for all old securities senior to the General Mortgage Bonds total less than 4½ million dollars (R. 349; col. III). The annual interest charges on the General Mortgage Bonds amount to about 1½ million dollars.

From the institution of these reorganization proceedings in 1935 up to the end of 1944 the Debtor's income available for interest has totalled approximately 50 million dollars (R. 349; col. II), and the total interest requirements for all creditors' claims senior to the General Mortgage Bonds have amounted to about 40 million dollars (R. 349; col. III), leaving a total of about $9,779,000—or an average of over one million dollars a year—of earnings available for the General Mortgage issue (R. 349; col. IV), being approximately two-thirds of the contract interest requirements of that issue. This period includes the five worst years in the present company's history (R. 348).

The Junction Bonds and the surplus cash

Of the 143½ million dollar capitalization authorized in the Plan, about 2¾ million dollars of new senior securities were to be issued in exchange for the Junction Bonds (the First Mortgage Five Per Cent Bonds of The Rio Grande Junction Railroad Company, a wholly-owned subsidiary of the Debtor, owning that part of Debtor's main line from Rifle to Grand Junction, Colorado.)

Some nine months after the proposed effective date of the Plan, the District Court directed that the Junction Bonds be paid or purchased from excess cash on hand (R. 262-3, 264-5), saying:

> "The Court: * * * *This railroad has an amount of cash here that it is not necessary to carry forward into the reorganization; it is not necessary for the proper financing of the new company, and even if this two million dollars plus is paid, there would still be plenty of working capital to go ahead with, under the plan.*
>
> "I have old-fashioned ideas, perhaps, and in all receiverships in this court, where there are debts and assets to pay them, I believe in paying off one's debts; that that is the best financing there is. * * *
>
> "So the order of the Court will be that these Rio Grande Junction Bonds be paid, with interest * * *
>
> "Mr. Gibson: If the Court please, with that ruling and order, may I ask your Honor whether you would consider reaching that result by way of purchase rather than a payment, in order to avoid serious income taxes?
>
> "The Court: Yes, you may make the order in any way so that it will avoid taxes or most convenient in considering these incidental questions that may arise * * *" (R. 262-3).

By the application of "surplus cash" (R. 262, 263), the first lien upon the Junction property, amounting to approximately 2¾ million dollars, has been eliminated—without the necessity of issuing the 2¾ million dollars of authorized Plan securities which the Commission had allocated to that particular purpose. After the application

of this surplus cash, more cash and "net current working capital" remained than were on hand at the time the Plan was promulgated (R. 278, 298). The system earning capacity has been in no wise decreased by the use of "surplus cash". If there has been no lessening of the earning capacity, there is no justification for any decrease in the total authorized capitalization. If the 2¾ million dollars of authorized securities were not "redistributed", as prayed by this respondent and as the Circuit Court of Appeals indicates should be done (R. 250-1), the net result would be that the authorized capitalization of the reorganized company would be *decreased* by that amount—although there would be no corresponding decrease in its earning capacity.

There is a precedent for such a "redistribution" of securities in this very case. The Commission's July 27, 1942 report and order reserved 2¼ million dollars of the authorized capitalization for possible new-money requirements (R. 121, 124, 145, 353). By the time that report and order reached the parties for their consideration, it seemed clear that the 2¼ million dollars of authorized capitalization reserved for new-money requirements was unnecessary and that accordingly, within the capital structure authorized by the Commission, that amount of capitalization had become available for redistribution. The Commission therefore "redistributed" the securities which had been reserved to cover new-money requirements (R. 161-2).

In similar situations in the *Milwaukee*[1], and *New Haven*[2] cases (reviewed later; this brief 31-33, 27-31), the plan securities allotted to the claims subsequently paid in cash were, upon such payment, redistributed to the other creditors—so that the total authorized capitalization was not

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[1] *Chicago, Milwaukee, St. Paul & Pacific Railroad Company Reorganization* (1943), 254 I. C. C. 707; 257 I. C. C. 223; (7th C. C. A. 1944) 145 Fed. 2d 299; certiorari denied (1945) —— U. S. ——, 65 Sup. Ct. 860, 89 L. Ed. 687.

[2] *In re New York, New Haven & Hartford R. Co.* (D. C. D. Conn. 1943), 54 Fed. Supp. 595; (1944), 257 I. C. C. 9; (2nd C. C. A. 1945), 147 Fed. 2d 40; certiorari denied (1945) —— U. S. ——, 65 Sup. Ct. 1578, 89 L. Ed. 1353.

thereby decreased. The General Mortgage Trustee applied for such a redistribution in the *Denver* case, but the District Court denied the application. The General Mortgage Trustee appealed from that order as well as from the order confirming the Plan.

The Circuit Court of Appeals reversed that part of the District Court's ruling, saying in part:

> "The Junction Bonds
>
> "We think that the complaint as to the manner in which the Junction Bonds were handled is well taken. The Rio Grande Junction Railroad is a wholly owned subsidiary of the Debtor. It had bonds outstanding in the hands of the public for the payment of which the Debtor was liable, totaling $2,758,333. This claim was senior to that of the General Bondholders. The plan set aside securities for the payment of this claim. In an order dated September 13, 1943, the District Court directed the trustee to pay this claim with some of the surplus cash on hand * * * The fact remains that the new capitalization provided securities for the payment of these bonds. * * * When surplus cash was used to pay this claim, the value behind the securities set aside for that purpose remained undistributed. * * * this undistributed value in all equity and fairness belonged to the General Bondholders. Any plan which does not give it to them does not comply with the requirements of Section 77(e) of the Act." (R. 250-1).

The Circuit Court of Appeals recognized that the redistribution would be made to the "various classes of creditors according to their priority in rank" (R. 246), holding:

> "* * * We think the interests of all parties can best be served by having the entire matter [including, of course, the equitable redistribution of the value represented by the undistributed securities]* reconsidered by the Commission and have it make all necessary adjustments." (R. 253).

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*Material enclosed by brackets, appearing in quotations, has been inserted by way of explanation.

Any competent accountant on the Commission's staff can work out such a redistribution so as to maintain the priority in rank of all classes of creditors established by the Commission. When such redistribution is accomplished, then, after all senior claims are paid in full either in cash or new securities or both, there will of course be left over within the valuation and capitalization fixed by the Commission new common stock available to the junior General Mortgage Bondholders in excess of the 10% of their claim originally provided for in the Plan.

It perhaps should be made clear at this point that this respondent at no time has made any claim that the General Mortgage Bondholders should receive cash or senior securities "released" through the payment or purchase of the Junction Bonds. A fair reading of the opinion below fails to disclose *any* requirement or direction by the Circuit Court of Appeals that any cash or new senior securities should be "awarded" or "allocated" to the General Mortgage issue. Statements to that effect (petition 2, 3, 10, 12, 13, 15, 16) are not correct.

The Circuit Court of Appeals pointed out that inasmuch as the senior bondholders had been satisfied in full (R. 247, 251; this brief 8), this "undistributed value" (i. e. 2¾ million dollars of the *authorized new capitalization—not* the senior securities released), in all equity and fairness belongs to the General Mortgage Bondholders (R. 251). The Commission has given the Debtor's property a "value" for reorganization purposes of 143½ million dollars. The Circuit Court of Appeals clearly was referring to part of this, the Commission's *value* for reorganization purposes, when it spoke of "this undistributed value" which "in all equity and fairness belonged to the General Bondholders" (R. 251).

Similarly, it was "value" for reorganization purposes which the Circuit Court of Appeals had in mind when it said, with respect to the decrease in other senior debt: "It would be inequitable to give this additional *value* to the Senior Bondholders when they have already been fully

compensated" (R. 251). The Circuit Court of Appeals agreed with this respondent that, in view of the great severity of the Plan in its proposed treatment of the General Mortgage issue, no further reduction in the authorized capitalization should be permitted and the General Mortgage Bondholders should be given the benefit of every available part of the authorized capitalization not required for the satisfaction of the claims senior to the General Mortgage issue.

The suggested "exclusion" of the Junction Bonds

Before leaving the question of the Junction Bonds, one other error in the petition should be corrected. The petitioners argue that the Commission "construed" the District Court's action in directing the purchase or payment of the Junction Bonds as an exercise of a reserved power to "exclude" the Junction Company (petition 7-8). That is clearly wrong. The Plan provided that, if the consolidation of the Junction presented difficulties which might delay consummation, the provisions for the holders of the Junction Bonds might be considered wholly separable (R. 166); but there has been no such finding, and no evidence has been introduced to that effect. Furthermore, it would have been improper for the Commission so to construe the District Court's action. If the Junction bondholders had been "excluded" from the Plan, there would remain *outstanding* a lien upon the Junction property in the hands of third persons. Through its stock ownership, the reorganized Debtor would have the Junction property, but subject to this outstanding 2¾ million-dollar lien. That is not our case. The Junction Bonds have not been excluded; they have been acquired or paid off—with cash accumulated after the Commission promulgated the Plan, which the District Court has several times described as "surplus cash" (R. 262, 263) not required for any of the purposes of the reorganization (R. 262).

The Utah Fuel stock

The statements in the petition in regard to the Utah Fuel stock, are erroneous and incomplete both as to the facts and the questions presented.

The Rio Grande Western Railway Company (a predecessor of the Debtor), in 1901 bought all the stock of Utah Fuel Company for $6,000,000 and paid for the stock by putting the stock under the Western Consolidated Mortgage (one of those senior to the General Mortgage) and issuing $6,000,000 of Western Consolidated Bonds to the former owner of the stock.

As of December 20, 1924, pursuant to a plan of reorganization, the Debtor entered into an agreement whereby the Utah Fuel stock was transferred to James S. Alexander, as trustee, still subject, however, to the lien of the Western Consolidated Mortgage, and it was provided that the income from the stock should be paid to the Debtor as long as any of the Debtor's General Mortgage Bonds or Refunding Mortgage Bonds should remain outstanding. Paragraph Fifth of the agreement provided that in the event of the foreclosure of the General Mortgage, the trustee under that agreement, upon the demand of this respondent, the General Mortgage Trustee, should sell the pledged Utah Fuel stock, still subject to the Western Consolidated Mortgage, the net proceeds to be applied to the payment of the General Mortgage Bonds and Refunding Mortgage Bonds, in accordance with the relative priority of lien of such mortgages—all pursuant to the directions and supervision of the court in charge of such foreclosure proceedings. By another agreement bearing the same date the Debtor assigned to this respondent, the General Mortgage Trustee, and to the trustee of the Refunding Mortgage all of the Debtor's rights and interests "in, to and under" the first agreement of December 20, 1924. Thus, in effect, this respondent has had since December 20, 1924, a junior lien upon the pledged Utah Fuel stock. (Transcript C. C. A. case Nos. 2906-7, Vol. 7, page 3171 et seq.) Title to the Utah Fuel stock was placed in a trustee to accomplish the purposes above described, but the real beneficial ownership

of the stock at all times has belonged to the Debtor herein and its creditors, including the General Mortgage Bondholders. Neither the Western Pacific nor the Missouri Pacific have any equity rights in the stock as long as the General Mortgage Bonds remain unpaid. Upon satisfaction of the Western Consolidated Bondholders' claim in full, the junior lienors are entitled to the benefit of this collateral.

Despite this fact background, the petitioners argue that "The Debtor does not own the Utah Fuel stock and never has", that this stock "is not the property of the Debtor" (petition 6, 21) and that accordingly the Western Consolidated Bondholders are entitled to retain the benefit of this stock *in addition* to receiving securities of the reorganized Debtor in the full face-amount of their claim. They cite as authority a case in which there was no junior lien on the collateral and accordingly not applicable here.

The Plan, after providing for the payment in full of the claim of the Western Consolidated Bondholders by the issuance of $20,056,400 in new securities of the reorganized Debtor, proposed, in addition thereto, to award to these creditors *all* the stock of the Utah Fuel Company, reputedly worth today between 4½ and 20 million dollars.

The Circuit Court of Appeals said, in part, with regard to this Utah Fuel stock:

> "There can be no question as to the duty resting upon these claimants [the Western Consolidated Bondholders] to credit the value of this collateral [the Utah Fuel stock] upon their claim before sharing in the securities of the reorganized company. They were entitled only to full payment. If the new securities which were assigned to them satisfied their claim in full, then the plan which permitted them to retain in addition this collateral would be inequitable and unfair to junior creditors.
>
> "The findings of the Commission are not clear as to the manner in which it treated this collateral. * * *
>
> "*Neither does the record establish with any degree of satisfaction the value of this collateral.* There is evidence which would support a conclusion that it had but little value. On the other hand, there

is evidence that the Utah Fuel Company is now prosperous and is enjoying large earnings, with reasonable prospects that they will continue.

"It appears to us that the plan contemplates that the claim of these creditors was to be *satisfied* from the new securities which were set apart for them, and that no particular value was ascribed to this collateral. If this collateral has any substantial value, it must be taken into account before the amount of new securities which are to be set over to these claimants is determined. *The Commission should clear up the doubts and uncertainties which surround this matter* when the proceedings are returned to it for further consideration" (R. 252-3).

The only question decided by the Circuit Court of Appeals relating to the Utah Fuel stock was that it could not properly decide upon the fairness of that part of the Plan dealing with the stock without knowing whether or not the Commission had determined the value of the stock, what that value is and whether or not the Commission intended to give it as a "bonus" to the Western Consolidated issue.

The Utah Fuel Company is an operating coal company owning lands containing estimated reserves of about 115,000,000 tons of coal, mining about 2,000,000 tons of coal per year, with gross operating revenues of about $6,000,000, and a substantial net income. The value of the Utah Fuel stock may today be between $15,000,000 and $20,000,000. The Commission's first report, back in the depths of the depression (R. 52), states that the Utah Fuel Company's balance sheet of December 31, 1936, shows the asset value of the Utah Fuel Company then to be over $15,000,000, the par value of the stock to be $10,000,000, with a 1936 corporate surplus of over 2½ million dollars—even in the depression. The Commission in its earliest report refers to a 1936 depression-year appraisal of the Company by someone employed by Guaranty Trust Company indicating a value of only $4,653,720. This low figure was reached by writing down the land value (land containing 115,000,000 tons of coal and now producing 2,000,000 tons annually) from about $10,000,000 to about $2,000,000 (Transcript C.C.A. Cases Nos. 2906-7, Vol. 9, pp. 4169-4282):

ARGUMENT

Question 1*

The Plan, which fails to provide for the distribution of the entire capitalization which the Commission found proper for the reorganized Debtor, is inequitable and unfair to the General Mortgage Bondholders. Under Rule 38, this question is not one this Court should review.

Under the decisions of this Court in the *Milwaukee*[1] and *Western Pacific*[2] cases, the determination of the proper amount of the capitalization of the reorganized Debtor is the function of the Commission. The Commission has found that without consolidation with the Denver & Salt Lake "there will be adequate coverage of fixed charges of the new company" and that the "value" of the property "for the purposes of this proceeding * * * is approximately $143,528,027" (R. 159). The Commission's Plan accordingly authorizes securities of the reorganized Debtor totalling that amount (R. 184).

Of those authorized, approximately 2¾ million dollars of senior-grade securities were intended for the purpose of taking care of the Junction Bonds (R. 183). They will not be required for that purpose, because the District Court has directed that "surplus cash" be used for their acquisition (R. 262, 263) and substantially all of them have been so acquired (R. 277-8).

The District Court nevertheless held that the Plan did not permit the redistribution of these securities, saying that "such a reallocation of securities can only be made by the Commission" (R. 223). Accordingly, with the Plan so interpreted, the actual capitalization of the reorganized Debtor is *reduced* by this amount of 2¾ million dollars below the

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*This brief page 3.

[1] *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.* (1943) 318 U. S. 523, 63 Sup. Ct. 727, 87 L. Ed. 959.

[2] *Ecker* v. *Western Pacific Railroad Corp.* (1945) 318 U. S. 448, 63 Sup. Ct. 692, 87 L. Ed. 892.

total fixed by the Commission, although the system has *all* of the assets and earning capacity contemplated by the Commission (this brief 12-16).

An additional $1,218,000 of the authorized capitalization represented debts due other senior creditors which have, since the Plan's promulgation, been paid in cash. As the Plan has been interpreted, this part of the authorized capitalization would also remain unissued and the actual capitalization would be reduced accordingly (R. 251).

The Circuit Court of Appeals has held that because of the foregoing the Plan "does not comply with the requirements of Section 77(e) of the Act" (R. 251). Obviously that must be so. No question is presented by that ruling which calls for the exercise of this Court's power of review.

Question 2*

The Plan, which gives senior creditors a "bonus" of 100,000 shares of Utah Fuel stock, without determining the value of that stock, is inequitable and unfair to the General Mortgage Bondholders, who have a junior lien on that stock. Under Rule 38, this question is not one this Court should review.

The Plan provides that the holders of the Western Consolidated Bonds shall receive 100% of their 20-million-dollar claim in new securities of the reorganized Debtor (R. 183). It also provides that these creditors shall receive all of the pledged Utah Fuel stock (R. 167). The Circuit Court of Appeals says that it "appears to us that the plan contemplates that the claim of these creditors [the Western Consolidated bondholders] was to be *satisfied* from the new securities [the securities of the reorganized Debtor] which were set apart for them, and that no particular value was ascribed to this collateral [the Utah Fuel stock]" (R. 253). That is a fair inference from the Plan language.

The Circuit Court of Appeals has held that the record does *not* "establish with any degree of satisfaction the value of this collateral" (R. 253). That decision is not a question of the type this Court should review under its Rule 38.

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*This brief page 3.

The General Mortgage Bondholders, who are to receive only 10% of their claim under the Plan (R. 183), have a junior lien on the Utah Fuel stock (this brief 17-8), and are entitled to share in the benefit after senior lienors have been satisfied.

The Circuit Court of Appeals has held that the "Commission should clear up the doubts and uncertainties which surround this matter" (R. 253). It is respectfully submitted that it would be impossible intelligently to pass upon the fairness and equity of the Plan without some determination as to the value of the Utah Fuel stock, upon which this respondent has a junior lien and which under the Plan is turned over to some of the senior creditors, with no duty upon them to account to the General Mortgage Bondholders. The instructions of the Circuit Court of Appeals are required by every consideration of fairness and do not present any question for the exercise of this Court's review power.

Question 3*

The Plan, which gives the senior creditors "their claims in full" and, in addition, surplus cash on hand, earnings already accumulated and excess war profits, is inequitable and unfair to the General Mortgage Bondholders. Under Rule 38, this question is not one this Court should review.

The Circuit Court of Appeals recognized that under the applicable decisions of this Court it could not itself increase the valuation fixed by the Commission, however much it might disagree with the Commission's conclusions—always provided that the Commission had not used "erroneous methods" of valuation (R. 244-5, 254). It also recognized that war earnings may be "disregarded in setting up the capitalized structure" for the reorganized Debtor (R. 247). It questioned, however, the propriety of disregarding entirely net earnings *already accumulated* as a result of swollen war earnings (R. 247) and said that a plan which gives the senior bondholders (a) "*their claims in full* by substan-

*This brief page 3.

tially delivering the road to them", and, in addition, (b) "the surplus cash actually on hand" and (c) "the excess war profits which are reasonably sure to come" is "*inherently inequitable and unfair*" as long as there are creditors whose claims are not fully satisfied (R. 247).

The senior creditors under the Plan are to receive about 97% of the securities of the reorganized Debtor. Thus, as the Court below says, the road is substantially "handed over" to them (R. 249). The General Mortgage issue, constituting almost one-fourth of the Debtor's outstanding indebtedness, is to receive the remaining 3% of the new capitalization. After pointing out that more than $43,000,000 of net earnings accumulated during the reorganization had been invested "in building a new railroad in many respects" (R. 249), the Court below admitted that the Commission was not compelled to add the "amount of these expenditures to the capitalized value" (R. 249), but the Court below indicated that the failure to do so accentuated an "inherent weakness" of the Plan in failing to make "equitable distribution of the excess current assets on hand" and the excess war profits (R. 248, 249). The Court below in this respect is in accord with the decisions in the *New Haven*, *Milwaukee*, *Florida East Coast* and *Missouri Pacific* cases hereinafter discussed (this brief 28-35).

It further said that there is "*more* than a speculative probability" that (a) the "war industries which have been constructed along the system" and (b) the "improvements which have been made by the use of these net earnings", together, may "produce greater net returns than anticipated in the plan" (R. 250) and it "suggested" a method by which the Commission could protect the interests of the General Mortgage Bondholders.

In doing this, it seems too clear for argument that the Circuit Court of Appeals has not required any "substantial change" in the capital structure by "adding additional new junior securities" or "additional new securities apparently of senior grades" (petition 2, 3, 19). The petitioners have misconstrued the Circuit Court of Appeals. The Circuit Court of Appeals "suggested", by way of remedy:

"*It could be done* by issuing to the General Bondholders an additional amount of a subordinate stock which would receive returns only from excess dividends" (R. 250). The Court, however, continued *immediately, in its very next sentence* as follows: "*This is a mere suggestion on our part, in no wise binding on the Commission.* Our duty is limited to pointing out defects in the plan. It is the responsibility of the Commission to correct them" (R. 250). Thus, the Court below has *not* held that "substantial changes" in the capital structure must be made or that "additional new securities" must be issued. There are many other ways of accomplishing the indicated correction. The Circuit Court of Appeals has made a suggestion; it has taken great care to say that it is only a "suggestion" and not "binding" on the Commission.

Question 4*

The General Mortgage Bondholders were reasonably justified in rejecting the Plan. Under Rule 38, this question is not one this Court should review.

Questions 4 and 5 have to do with the so-called "cram-down" provision of Section 77(e). Neither of them need now be considered by this Court unless this Court were first to determine that the Circuit Court of Appeals was wrong about the Junction Bonds question, about the situation presented by the decrease in other senior indebtedness, about the Utah Fuel stock, about the equitable distribution of accumulated earnings, in fact about every question having to do with the inequity and unfairness of the Plan.

The petitioners have made an error in stating that the Circuit Court of Appeals has ruled that "the dissent of the General Mortgage bondholders precluded confirmation of the Plan" (petition 23). An examination of the opinion will show that it contains no such holding. The Circuit Court of Appeals pointed out numerous respects in which it found that the Plan was *inequitable* and *unfair* and *did not comply*

*This brief page 4.

with the requirements of Section 77(c) and *then* held: "It follows from what has been said that the General Bondholders were reasonably justified, within the meaning of the statute, in rejecting the plan, * * *" (R. 253). The Court decided, first, that because the Plan was not fair and equitable, the rejection vote was reasonably justified; and, secondly, that, because the Plan was not fair and equitable *and* because the rejection vote was reasonably justified, the District Court erred in confirming the plan (R. 253). That is very far removed indeed from the assertion that a rejection vote "precludes" confirmation.

The position of the petitioners on the cram-down provision seems to be that Section 77(c) does not mean what it says, that the provision for submitting a plan of reorganization to creditors for a vote is meaningless, that no creditor can be "reasonably justified" in voting to reject a plan once the District Court has found it "fair and equitable" (which the District Court under the statute is required to find *before* any plan can be *submitted* to security holders for a vote). If the petitioners were right about this, it would mean that everything prescribed in Section 77 as the procedure to be followed after an "approval" order is a futile waste of time and money—that the Congress was imposing meaningless procedural red tape in providing so carefully for the submission to creditors and that the Commission was merely shadow boxing in conducting, tabulating and reporting with such meticulous care the vote of each class of creditors.

This respondent respectfully submits that such cannot be presumed to have been the intent of Congress. The statute means just what it says. After a rejection vote, the Court may not confirm the plan—cram it down the throats of the class of creditors which rejected it—unless the Court properly finds, on the basis of competent and convincing evidence, that the rejection was not reasonably justified in the light of the relevant facts—that those who voted to reject acted from some improper motives, or were arbitrary or capricious in their action. No evidence to

that effect was offered. It would be impossible, it would seem, to show that the rejection vote was unreasonable when the unanimous Circuit Court of Appeals found that the Plan was "inherently inequitable and unfair" (R. 247) and "fails to meet the requirements of Section 77(e) * * *" (R. 251, 253). If anything more were needed, it is obvious that the unanimous House Judiciary Committee felt the same way about the Plan—as can be seen from the extracts from a committee report which appears as a footnote to the opinion of Judge Phillips (R. 255-9). Unless all three Judges of the Circuit Court of Appeals for the Tenth Circuit and all members of the House Judiciary Committee were unreasonable, it would seem impossible to hold that the rejection vote was not reasonably justified.

But this Court cannot review the decision below that the rejection was "reasonably justified, within the meaning of the statute," i. e. "in the light of * * * all the relevant facts" (Section 77(e)), without reviewing all of the voluminous record before the Circuit Court of Appeals. Whether or not this Court might have reached a different conclusion (and this respondent submits it would not) this is not the type of question this Court, under its Rule 38, should review on certiorari.

Question 5*

The constitutional question is not now presented.

The constitutionality of Section 77 was sustained by this Court in the *Rock Island*[1] case by an analogy to compositions. About five months *after* the decision of this Court in the *Rock Island* case, the statute was amended by the addition of the cram-down provision in its present form. If that provision is interpreted to mean that the District Court may, under the circumstances specified, confirm a plan in the absence of the statutory two-thirds vote of ap-

*This brief pages 4-5.

[1] *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Railway Co.* (1935), 294 U. S. 648, 667-75, 55 Sup. Ct. 595, 79 L. Ed. 1110.

proval provided that at least a *majority* vote of approval is obtained, then the amended statute may be sustained on the basis of the *Rock Island* case reasoning. But, if the cram-down section were interpreted to mean that the District Court may confirm a plan in the *absence* of even a *majority* vote of approval, then it would be necessary to find some other basis upon which to sustain the constitutionality of the statute. The reasoning upon which this Court relied in the *Rock Island* case would no longer be applicable.

In the *Radford*[1] case, in holding the Frazier-Lemke Act unconstitutional, this Court said:

> "* * * In no case of composition is a secured claim affected except when the holder is a member of a class; and then *only when the composition is desired by the requisite majority and is approved by the court.* * * *." (295 U. S. 585-6).
>
> "* * * The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. * * *" (p. 589).

In discussing the power of the bankruptcy court to enforce a composition between creditors, this Court further observed:

> "* * * It is the same power which a court of equity exercises when it compels dissenting creditors, in effect, to submit to a plan of reorganization approved by it as beneficial and assented to by the requisite *majority* of the creditors. * * *" (p. 585).

But, unless this Court were first to conclude that it should (1) review and (2) reverse the Circuit Court of Appeals on each of questions 1 to 4, inclusive, this constitutional question is not now presented for consideration.

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[1] *Louisville Joint Stock Land Bank* v. *Radford* (1935), 295 U. S. 555, 55 Sup. Ct. 854, 79 L. Ed. 1593.

The opinion below is in accordance with the decisions in other circuits.

The New Haven case (2d Cir.)

A "redistribution" of part of the authorized capitalization, similar to that suggested in our *Denver* case, was made in the *New Haven*[1] reorganization where about $26,000,000 of surplus cash was used to reduce senior claims after the New Haven plan came out.

Judge Hincks, in discussing the first 18 million dollars of cash used in reducing these senior claims in the *New Haven* case, said in part:

> "* * * As a result of these * * * payments the aggregate amount of the secured claims has been reduced and if new securities were now to be used * * * for the discharge of the old [unpaid] securities there would be needed * * * [18 million less of new securities]. *This would produce a capital structure in which the bonded indebtedness was less than that which in the judgment of the Commission the enterprise could reasonably be expected to support. Thus a block of $6,599,290 in fixed interest bonds and $11,658,890 in income bonds became available to sweeten the treatment previously proposed for all mortgage creditors who had not already received an allotment * * * equal to the amount of their claims.* * * *

> the Commission * * *. These relationships can be established by mathematical computations based solely upon findings of the values of the several issues already made by the Commission * * *." (p. 608)

Pursuant to this decision, the Commission on February 8, 1944[1] worked out the redistribution of the released securities, saying in part:

> "Consistently * * * in accordance with the Court's interpretation, the plan should also be corrected to provide that, *if*, pending reorganization, any future *payment * * * shall reduce or eliminate the claim of a secured creditor or of a class of secured creditors, the excess new fixed interest or new contingent interest bonds allocated to such creditor or class of creditors * * * thus released and becoming available shall be redistributed under the method used in the formulation of appendix A * * * *" (257 I. C. C. 11).
>
> "*Accordingly * * * if the claims are so paid, the securities allocated to the banks under the plan will be distributed to other secured creditors.* * * *" (257 I. C. C. 13).

Altogether about $26,000,000 cash accumulating after the Plan came out was used in the *New Haven* case to reduce senior claims and the new securities thereby released were redistributed.

The District Court in our *Denver* case denied this respondent's petition for a similar redistribution of the securities released by the payment or purchase of the Junction Bonds, although apparently it may not have fully agreed with the treatment accorded the General Mortgage issue. For example, in the confirmation order Judge Symes said:

> "The court in its plan of March 6, 1941, gave the General Mortgage bondholders more common stock than does the approved plan. The Commission, how-

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[1] *New York, New Haven & Hartford Railroad Reorganization, Finance Docket 10992*, fifth supplemental report, dated February , 1944, 257 I. C. C. 9.

ever, could not agree with our views, and it would seem to be a useless gesture for the court to make the same error again, assuming we had the power" (R. 221).

This respondent having pointed to the New Haven precedent, the Court, in refusing to follow it, said:

> "Frankly, I do not believe the court has the power to make the reallocation requested by the General Mortgage trustee * * *" (R. 217).
>
> "* * * *the action of Judge Hincks is hardly authority—at least until approved by an appellate court.* * * *" (R. 216).

Thereafter, however, the Circuit Court of Appeals, Second Circuit,[1] upheld Judge Hincks' decision on this redistribution matter and also upon the procedure followed by the New Haven court, saying:

> "* * *. We regard it as a commendable instance of 'properly coordinated action' between the Court and the Commission, the importance of which was noted in Ecker v. Western Pacific R. Corp., 318 U. S. 448, 475; 63 S. Ct. 692, 708; 87 L. Ed. 892." (147 Fed. 2d 44-5).

In the *New Haven* case the Circuit Court of Appeals reversed the District Court decision on another point, ordering a further adjustment within the framework of the Commission's plan, because of inequitable treatment of one class of creditors, and petitions for writs of certiorari were denied June 18, 1945.[2]

The decision of the Circuit Court of Appeals in our *Denver* case is in accord with the *New Haven* case on the jurisdiction and power of the Circuit Court of Appeals to reverse the District Court and order a plan remanded for adjustments whenever within the framework of a reorgan-

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[1] *In re New York, New Haven & Hartford R. Co.* (2nd C. C. A. 1945) 147 Fed. 2d 40, 48.

[2] *In re New York, New Haven & Hartford R. Co.* (1945) —— U. S. ——, 65 Sup. Ct. 1578, 89 L. Ed. 1553.

ization plan it is inequitable and unfair to one class of creditors. It is also in accord with the *New Haven* case upon the merits of using surplus cash to reduce senior debts, the redistribution of the securities thereby released among the other creditors and in having the adjustments made by the Commission.

The Milwaukee case (7th Cir.)

Similar adjustments and redistribution of securities released as a result of utilization of surplus cash to reduce senior claims have been made in the *Milwaukee* case in connection with the carrying out of the decision of this Court. It should be noted that in the *Milwaukee* case, the *New Haven* case, and in the *Missouri Pacific* and *Florida East Coast Ry.* cases, later reviewed, the Courts *considered and utilized the surplus cash and working capital accumulated after the Commission's plan came out.* Petitioners' argument that Courts *cannot* consider surplus working capital and cash accumulating after the date of the Commission's findings, or after the effective date of the Commission's plan, is contrary to all these decisions.

The manner in which the Commission made such adjustments in the Milwaukee plan is shown in the Commission's report[1] of December 6, 1943. At the end of the report, the Commission has made a "summary" of its changes, saying:

> "For the reasons stated, we conclude and find that the plan * * * should be adjusted, modified and corrected in the following respects, * * *
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> * * * * * * *
>
> "(2) That approximately $52,038,036 be distributed in cash among the bondholders, as hereinbefore described, and as shown in appendices A and B * * *.
>
> "(3) That $7,096,336 of new first-mortgage bonds, be issued to creditors * * * as approximately repre-

[1] *Chicago, Milwaukee, St. Paul & Pacific Railroad Company Reorganization*, Second Supplemental Report, dated December 6, 1943, Finance Docket No. 10882, 254 I. C. C. 707; modified by Third Supplemental Report, dated April 10, 1944, 257 I. C. C. 223.

> senting the amount by which the claim of the Finance Corporation has been reduced, the payment of the loan of the Continental * * *.
>
> "(4) That by reason of the foregoing, adjustments and modifications be made in the allocation of certain new securities to certain classes of creditors * * * as shown in appendices A and B hereto." (254 I. C. C. 737).

The payment of the $52,000,000 cash in the *Milwaukee* case in reduction of senior claims and the redistribution of securities thereby released was approved by the Circuit Court of Appeals, 7th Circuit,[1] where the Court, in dismissing the appeal, said in part:

> "When the proceeding found its way back to the Commission, a large amount of cash had accumulated from the operation of debtors' railroad system, and the Commission ordered the distribution of some $52,000,000 of this cash to senior creditors * * * The action of the Commission in this respect was approved by the District Court." (145 Fed. 2d 302).

The District Court in our *Denver* case refused to follow the *Milwaukee* case in this respect. The Circuit Court of Appeals' decision in our *Denver* case, reversing the District Court, followed and conforms to the *Milwaukee* case.

The Florida East Coast case (5th Cir.)

The Circuit Court of Appeals' decision in our *Denver* case also conforms to the decisions in the *Florida East Coast* Case.[2]

In the *Florida East Coast* case, the Commission's plan (effective date December 31, 1940) fixed the new capitalization of the reorganized company at $37,000,000. The debtor had two mortgages. The old first mortgage secured

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[1] *In re Chicago, Milwaukee, St. Paul & Pacific Railroad Company* (7th C. C. A. 1944), 145 Fed. 2d. 299.

[2] *In re Florida East Coast Railway Co.* (D. C. S. Fla. 1943), 52 Fed. Supp. 420.

$12,000,000 of bonds which under the plan were to get 100% in new first mortgage bonds. The junior mortgage secured $45,000,000 of bonds; which under the Commission's plan were to get about 50% of their claim in new securities (10% of the claim in new second mortgage bonds, and about 40% in new common stock). The junior bonds were in a position similar to that of the junior General Mortgage Bonds in the *Denver* case (the treatment proposed for the Florida junior bondholders, however, was far less drastic).

By the time the Commission's plan in the *Florida East Coast* case came before the Court for consideration, the available net income had jumped from less than one million to over nine million dollars a year. The cash on hand had climbed from about 1¼ millions to over 17¾ millions.

The Court found that this great *accumulation* of cash not only made it necessary to give the old junior bonds more and better new securities, but required many other major changes. On motion, the Court sent the plan back to the Commission.

Judge Strum in the *Florida* case said in part:

> "This sum of $17,795,365 on hand October 1, 1943, is an existing fact, not a prophecy. * * *
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> * * * * * * *
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> "This cash represents net earnings of the company, on which the bondholders have a lien. To the extent that it is prudently available, the bondholders are entitled to the benefit of this surplus cash, either by having it applied in an equitable manner in satisfaction of their claims, or by having it otherwise definitely allocated by the Commission as a component part of the reorganization plan, so that it may be equitably applied to the best advantage of all concerned. * * * *To approve the present plan, ignoring the existence of this fund, would be improvident and inequitable to all security holders, especially to the minority. Such a course would not afford due recognition to the rights of the present bondholders, who have liens on these funds.*" (52 Fed. Supp. 422-3).

Pursuant to this decision, the Commission, on January 8, 1945,[1] modified the Florida East Coast plan, giving the Florida East Coast junior bondholders 100% of the principal of their claim in cash and new securities (in place of the 50%, largely in new common stock, provided in the earlier plan). The Commission accomplished this result, largely by using net earnings which had accumulated after the effective date of the Commission's Plan to pay off and reduce senior claims.

The Missouri Pacific case (8th Cir.)

The decision of the Court in the *Missouri Pacific* case[2] is along the same line. The District Court in 1941 had approved the Commission's plan. While appeals were pending from the approval order, the Commission submitted the plan to the creditors, and a majority of one or more classes of creditors rejected it. Thereafter the C. C. A. 8th Circuit, on appeal from the approval order, sent the case back for reconsideration. The plan then came before the District Court for confirmation on July 16, 1943.

The District Court held the plan inequitable and sent the plan back to the Commission for adjustments, suggesting that surplus cash on hand from wartime earnings be used further to reduce senior claims. The Court said in part:

> "* * * The revenues and earnings of this road, like others, has increased tremendously during the past few years, resulting in a sizable increment of cash. * * *
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> * * * * * * *
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> "It appears, therefore, * * * the accumulated cash might well be used to liquidate some or all of these especially preferred claims. * * *
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> * * * * * * *

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[1] *Florida East Coast Railway Company Reorganization*, I. C. C. Finance Docket 13170, Second Supplemental Report, dated January 8, 1945. —— I. C. C. ——.

[2] *In re Missouri Pacific R. Co.* (D. C. E. D. Mo. 1943), 50 Fed. Supp. 936.

"* * * For * * * reasons, stated above, we must refer this matter back to the Interstate Commerce Commission. * * *" (50 Fed. Supp. 941, 942, 943).

Pursuant to Judge Moore's decision in the *Missouri Pacific* case, the Commission since then has certified an adjusted Missouri Pacific plan[1] carrying out the decision. The Commission took $30,000,000 to $35,000,000 of the cash from net earnings during trusteeship and reduced the senior claims, thereby improving the treatment of junior bondholders within the framework of the plan.

CONCLUSION

No "special or important reasons" exist in this case calling for the exercise of this Court's power of review or supervision. The determination by the Circuit Court of Appeals that the Plan is inequitable and unfair, and the reasons given therefor, are not in conflict, in any respect, with any decision of another Circuit Court of Appeals on the same matter or with the applicable decisions of this Court. That determination does not in any respect come within any other of the several classifications listed in this Court's Rule 38, paragraph 5(b).

Under facts showing that within the valuation and framework of the Commission's Plan, the proposed treatment of the junior General Mortgage Bondholders is unfair and inequitable and that their rejection of the Plan was reasonably justified, the Circuit Court of Appeals has jurisdiction and power to order the Plan referred back to the Commission for equitable adjustments.

The Circuit Court of Appeals' decision follows and conforms to all the decisions hereinabove reviewed and is merely a step towards accomplishing in the reorganization

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[1] *Missouri Pacific Railroad Company Reorganization*, Supplemental Report, dated July 4, 1944, Finance Docket 9918, 257 I. C. C. 479; modified by Third Supplemental Report, dated October 9, 1944, 257 I. C. C. 745.

of the Debtor what has already been accomplished by similar decisions in the reorganization of the Milwaukee, the New Haven, the Florida East Coast and the Missouri Pacific railroads.

The asserted questions alleged in the petition are based upon misconstruction of the Circuit Court of Appeals' decision and upon incorrect assumptions of fact as hereinbefore pointed out.

The Circuit Court of Appeals' decision upholds the valuation fixed by the Commission, makes no award of released securities or surplus cash to the General Mortgage bondholders or to any class of creditors, but leaves "all equitable adjustments" to the Commission, including the redistribution of released securities and surplus cash, so that claims of various classes of creditors will be taken care of "according to their priority in rank."

It is respectfully submitted in behalf of City Bank Farmers Trust Company, as Trustee under the Debtor's General Mortgage, that the petition for writs of certiorari filed by the Reconstruction Finance Corporation, Insurance Group Committee and others, should be denied.

Respectfully submitted,

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August 31, 1945.